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SUBJECT: SERBIA: OBSTACLES TO FOREIGN DIRECT INVESTMENT

REF: a) STATE 0460

SUMMARY  
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¶1. During a series of meetings, business representatives, local analysts, and government officials told us significant impediments remained to foreign direct investment (FDI) in Serbia. All observers highlighted political instability and the difficulty in obtaining permits for construction on urban land as major concerns for domestic and foreign investors alike. Corruption, especially regarding permits and licenses, is problematic. Overall, our contacts believe Serbia views U.S. firms positively and there is strong interest for more direct investment from the United States. End Summary.

INVESTORS FOCUSING ON POLITICAL RISK...  
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¶2. The Serbia Investment and Export Promotion Agency (SIEPA), Foreign Investors Council (FIC), and business executives during a series of meetings the week of July 28 through August 1 commented to us on the importance of political stability to foreign investors and on recent political developments that were raising confidence in the country's investment climate. Bozidar Laganin, special advisor to the SIEPA Director, and Ana Vlajic, Executive Director at FIC, said that political risk has been the biggest problem for foreign investors in Serbia over the last few years. Vlajic emphasized the uncertainty stemming from "too many elections" within the last two years as having had a negative impact on the development of business strategies for FIC members, rendering the business climate unstable and unpredictable. The elections also exacerbated the government's lack of capacity in implementing and enforcing existing laws adequately.

¶3. Aside from obstacles, Laganin also spoke of the new government's prospects for attracting FDI, particularly in greenfield projects, noting that only 25% of Serbia's total FDI stock was greenfield investment at best (Comment: the government adopted a plan on July 21 to refund 25% of funds to greenfield investors who invested at least 200 million euros and created a minimum of 1000 jobs in the automotive, IT, electronics, or telecommunication sectors). Also, the deal signed in April between Zastava and Italian auto manufacturer Fiat on establishing a joint venture (reftel A) in Kragujevac had sparked investor interest in Serbia, according to Laganin.

¶4. Regarding the new government, all individuals with whom we met were cautiously optimistic that the coalition would stay together and push through needed reforms. Marko Micanovic of Altis Capital, a financial advisory firm, said that the Democratic Party (DS) "has to show something now" by pushing through business-friendly reforms in the country's regulatory framework, noting that former Prime Minister Kostunica's party achieved more during its first term than last year's DS-led coalition.

## ...AND LAND PERMITS

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15. Zoran Skopljak, regulatory affairs advisor at the American Chamber of Commerce (AmCham), told us that problems related to land titles and permits were a key obstacle for foreign investors in Serbia, a view shared by FIC. The 2006 Constitution ended the state's monopoly on owning urban land, but many laws had yet to be changed to correspond to the constitution, effectively perpetuating state ownership of urban property. As a result, companies experience major difficulties in obtaining building and construction permits, which at times range from "two months to two years." The uncertainty surrounding urban land ownership has led to companies being able to own a building, but not the land the building occupies. The situation hinders investment and capital expenditures by compelling businesses to operate in a legal grey zone. Executives at the engineering and construction firm Energoprojekt reinforced this view, commenting on the inability to buy or sell urban land and how land permits and paperwork for licenses were not properly regulated.

## SHALLOW CAPITAL MARKETS, POOR INFRASTRUCTURE

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16. Observers also mentioned capital market issues and poor infrastructure as additional impediments to FDI. Skopljak stated that restrictions on capital outflows and money transfers deter some holding companies from doing business in Serbia. This makes "cash pulling" more difficult, where companies move funds among subsidiaries, leading some Serbian companies to move their activities abroad. Also, low liquidity on the Belgrade stock exchanges and the lack of deep markets for municipal bonds restrict access to a larger pool of funding and keep foreign investors away, according to local investment consultant Milan Kovacevic. Regarding infrastructure shortcomings, SIEPA and local economic journalist Misa Brkic said that poor roads, railways, and airports constrained investor projects. The low quality of public services delivered kept business costs high (even in relatively well-off places in Vojvodina), hurting FDI and keeping investors away, according to Vlajic.

## CORRUPTION REMAINS A MURKY ISSUE

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17. All agreed that corruption was a concern, but no one emphasized it as among the most pressing problems or put forward any specific examples. The difficulties in obtaining construction permits create an environment where those looking to build or expand facilities depend on the goodwill of municipal authorities, therefore leading to opportunities for bribe solicitation. FIC spoke in terms of seeking a level playing field for all participants and that rules needed to apply to everyone equally, suggesting that clientelism was present in some forms at both the central government and municipal level. Investment consultant Kovacevic said outright that the perception of corruption was bigger than the actual level because government clerks and institutions did not function transparently. Contacts at U.S. firms in Serbia have spoken to Embassy about kickbacks and shady practices regarding licenses and permits in the "third level of government," i.e., among administrators and regulators. These contacts state that they in no way participate in such practices, and once they have established their position, are rarely re-approached in such a manner. Nevertheless, they must still navigate the quagmire that such an environment creates to get business done.

## COMMENT

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18. Everyone the Embassy spoke with last week echoed the same concerns: political stability, corruption, infrastructure, efficiency and transparency. All observers, however, were optimistic about the new Prime Minister Mirko Cvetkovic. They considered Cvetkovic was a pragmatic former Minister of Finance in the last government and a proponent of western investment. However, fiscally imprudent coalition concessions such as the anticipated 10% increase in pensions may impact the investment climate with higher

inflation and further macroeconomic instability. Both the public and private sectors remain highly interested U.S. FDI, placing political differences behind commercial interests. In fact, as AmCham mentioned, U.S. investment has been viewed positively in some regions such as in Smederevo (approximately 30 miles east of Belgrade) where US Steel's presence raised average salaries there and stimulated other commercial activity. We are skeptical of assertions that corruption plays a tertiary role in discouraging foreign investment. Our contacts more likely were reluctant to discuss corruption's saturation of Serbian society. Certainly greater transparency in business transactions and expectations of political stability will help to address the root causes of corruption in Serbia. End Comment.

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